Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Bates	Analyst:	Rachel Coco	Bill Number:	AB 2325
Related Bills:	See Legislative History	Telephone:	845-4328	Introduced Date:	February 19, 2004
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Employer Credit For Wages Paid To Disabled Persons

SUMMARY

This bill would provide employers a tax credit for wages paid to disabled employees.

PURPOSE OF THE BILL

According to the author's office, the purpose of the bill is to encourage employers to hire disabled individuals.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective upon enactment and operative for taxable years beginning on or after January 1, 2004.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Existing state and federal laws allow a taxpayer to deduct expenses paid or incurred in the ordinary course of a taxpayer's business, including employee wages and benefits.

Existing state and federal laws provide various tax credits that are designed to provide tax relief for taxpayers who must incur certain expenses (e.g., renter's credit) or to influence behavior, including business practices and decisions (e.g., research credits). For instance, under current federal law, eligible small business owners are allowed a tax credit in an amount equal to 50%, not to exceed $10,250, of the costs attributable to providing disabled access.

THIS BILL

This bill would provide a tax credit in an amount equal to 10% of the wages paid to an eligible employee.

Board Position:			Department Director	Date
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The bill would define the term "eligible employee" to mean a disabled person employed by the taxpayer within California.

The bill would define the term "disabled person" to mean any person who has a physical or mental impairment that substantially limits one or more major life activities.

The bill specifies that the credit would be allowed only during the first two years of employment. The bill would limit the amount of the credit to $3,000 for the first year of employment and $2,000 for the second year of employment.

This bill would allow any unused credit to be carried over until exhausted.

<u>IMPLEMENTATION CONSIDERATIONS</u>

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

The definition of a disabled person as provided by this bill appears to be the same definition as provided by the American With Disabilities Act (ADA). To avoid any confusion between the department and taxpayers, the author may wish to amend the bill to include a reference to the act in order to be more specific about criteria that would qualify an employee as disabled.

While it appears that an eligible employee is one employed within this state, the definition could be interpreted to mean that only the taxpayer be in the state or even that both the taxpayer and the employee be in the state. To alleviate confusion, the author may wish to amend the bill to specify that an eligible employee is one who is disabled, employed by the taxpayer, and performing services within California.

This bill does not require any type of certification of disability in order for the employer to claim the credit. Other hiring credits have been enacted with a voucher requirement for purposes of certifying the taxpayers eligibility. Typically, credits involving areas outside of the expertise of the department are certified by another agency or agencies that possess the relevant expertise. The author may wish to amend the bill to require that the employer obtain a voucher, possibly from a federal or state agency familiar with the disability statutes, certifying the disability of each qualifying employee.

The credit would apply to the first two years of the employment of the eligible employee. However, the bill is silent about whether that period can reoccur. For example, a taxpayer could terminate an eligible employee at the end of the second year, rehire the employee, and claim the wages paid to the employee under a new two-year employment period. The author may wish to limit an employee to being an "eligible employee" once.

The dollar limitation provision limits the credit by reference to the first and second year of employment. In a situation where an employee's employment overlaps multiple taxable years, the bill is unclear how this limitation should be applied. For example, if an employee is hired July 1st that employee's first year of employment would end the following July 1st. It is unclear whether the employer would be allowed the credit up to $3,000 for the period beginning July 1st and ending December 31st or whether the $3,000 limitation would be applied in some manner (pro rata, for example) to the two taxable years. The author may wish to amend the bill to provide clarity as to how the credit shall be applied in such an instance.

LEGISLATIVE HISTORY

AB 2801 (Horton, 2003/2004) would reinstate the jobs tax credit. The bill would provide the taxpayer a credit in an amount equal to 10% of wages paid to qualified employees who are certified by the Employment Development Department to meet certain requirements. This bill is currently in the Assembly Revenue and Taxation Committee.

SB 1121 (Margett, 2001/2002) would have allowed employers a credit in an amount equal to 40% of qualified wages paid to individuals who were state disability insurance recipients. SB 1121 failed to pass out of the originating house by the constitutional deadline.

OTHER STATES' INFORMATION

Florida, Illinois, Massachusetts, Michigan, Minnesota, and *New York* laws do not currently provide a credit comparable to the credit that would be allowed by this bill. The laws of these states were reviewed because their tax laws are similar to California's income tax laws.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

<u>Revenue Estimate</u>

The projected revenue losses below reflect orders of magnitude:

Revenue Impact of AB 2325 *(In Millions, rounded to nearest $10 Million)*		
2004/2005	2005/2006	2006/2007
-$320	-$330	-$350

This estimate does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

<u>Revenue Discussion</u>

The impact of this bill would depend on the population of qualified disabled employees, the amount of wages paid in their first or second year of employment, and the average credit applied against tax liabilities of qualified employers.

According to a report by the Employment Development Department, California employs roughly 2 million individuals with a disability, which is 54.9% of the 3.8 million individuals classified as having "any" disability. A new hire rate of 5% was assumed, giving a potential number of "qualified" disabled employees of 100,000 in any given year.

Further, statistical data determined that generally a disabled worker is employed on a part-time basis equal to 1,500 hrs/year and earns 66% of the statewide average hourly wage of $16.11, for a potential qualified wage base per disabled employee of roughly $16,000 (1,500 hrs x $10.63 avg. wage = $16,000.)

Since this bill would allow a credit equal to 10% of wages paid, it is estimated that a qualified employer would claim an average credit of roughly $1,600 per tax year (10% credit x $16,000 annual wage = $1,600) for the first two taxable years as follows:

For 2003, 100,000 disabled workers hired x $1,600 credit	= $160 million
For 2004, 100,000 disabled workers hired x $1,600 credit	= $160 million
Total revenue loss for fiscal year 2004/2005	= $320 million

This number is projected to grow 5% per year into subsequent years.

This estimate does not reflect any offset for the tax effect from a reduction in corresponding wage expense deductions based on the current language of this bill.

POLICY CONCERNS

This bill does not specify a repeal date or limit the number of years for the carryover period. Credits typically are enacted with a repeal date to allow the Legislature to review their effectiveness periodically. However, even if a repeal date were added, the department would be required to retain the credit on the tax forms indefinitely because an unlimited credit carryover period is allowed. Recent credits have been enacted with a carryover period limitation since experience shows credits are typically used within eight years of being earned.

This bill would have the effect of providing a double benefit for deductible wages by virtue of this credit and the ordinary deduction of these wages from the income of the trade or business.

LEGISLATIVE STAFF CONTACT

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